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## I. INTRODUCTION

Economics is the lodestar for antitrust law and sound competition policy. Economic reasoning plays a key role in identifying the problems being litigated and framing the legal rules that will be applied to these problems. *McWane Inc. v. Federal Trade Commission*,[2] currently on appeal to the 11th Circuit, has the potential for illuminating important economic concepts in an area of antitrust law that is rarely addressed on appeal—identifying the relevant market.

In *McWane*, the U.S. Federal Trade Commission ("FTC") relied on qualitative data unsupported by robust economic analysis to narrowly define a market, even though market data was available. Appellate decisions on relevant markets are sparse and this case could provide a vehicle to reassert the importance of using established economic tests to accurately gauge relevant markets.

## II. THE NEED FOR EMPIRICAL ECONOMIC METHODS

The benefits of empirical economic methods in antitrust are well recognized. "[T]he use of economic methods helps focus the attention of decision-makers and litigants on the connection between the economic theory of the case and the evidence."[3] This use of empirical economic methods forces the plaintiff "to state, with reasonable specificity, what competition might be harmed by the challenged practices. . . ."[4] It "also permits the defendant to rebut the idea that competition is fragile enough to be harmed, by attempting to establish a wider market."[5]

Identification of the relevant market can be done with either quantitative or qualitative economic evidence. "But when qualitative evidence is employed, the underlying economic logic of the identification strategy is often analogous to an approach to identification taken in the empirical economics literature with respect to quantitative evidence."[6] Reliance on well-accepted methods of identification is crucial because of the occurrence of false positives or false negatives due to external factors.[7] For this reason, qualitative data should be supported by an established economic test unless good market data is scarce. Then, and only then, should a plaintiff be permitted to sidestep this important evidence based on necessity.

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[2] McWane Inc. v. Federal Trade Commission, No. 14-11363 (11th Cir. filed Mar. 28, 2014).

[3] HANDBOOK OF ANTITRUST ECONOMICS 3-4 (Paolo Buccirossi ed. 2008)

[4] *Id. at* 7.

[5] *Id.*

[6] *Id.* at 11.

[7] *See*, *e.g.*, *id.* at 19-23.

This desire to have identification grounded in established economic methods is apparent in the case law. The Supreme Court stated over 50 years ago that:

> [i]n considering what is the relevant market for determining the control of price and competition, no more definite rule can be declared than that commodities reasonably interchangeable by consumers for the same purposes make up that 'part of the trade or commerce,' monopolization of which may be illegal.[8]

Courts have widely applied this rule by requiring a relevant market to be defined by an economic test supported by expert testimony.[9] One of the most used economic tests is the measurement of the cross-elasticity of demand between the product and its substitutes.[10]

## III. CONCERNS REGARDING THE FTC'S MARKET ANALYSIS IN *McWANE*

Given the importance of economics in defining markets and measuring market power, it is surprising how economically sparse the FTC's market analysis was in its *McWane* decision.[11] In *McWane*, the FTC defined a market consisting of domestically manufactured iron pipe fittings; even though these iron pipe fittings are functionally interchangeable with foreign produced iron pipe fittings. The Commission relied on two pieces of evidence in defining a domestic fittings market: 1) the existence of a small portion of consumers that required domestically manufactured iron pipe fittings, either by preference or encoded in local laws, in their specifications, and 2) the difference in price between fittings sold into open and domestic-only specifications.[12] Neither of these facts is especially persuasive without being backed up by a robust and accepted economic test supported by expert testimony, and that was clearly absent from the record in this case.

What is more surprising is what the FTC did not do in *McWane*. The FTC did not identify or study specific customers to make sure that they had hard preferences significant enough to support a separate market. The FTC's expert economist did no economic tests of any of the relevant markets.[13] The expert's opinion was instead based on certain documents and testimony and not the result of any economic test such as a study of the cross-elasticity of demand.

One factor considered in *McWane* was a desire to buy American-sourced products. But a consumer's preference to "buy American" is not sufficient to create an entirely separate market. For one, such a ruling could create separate markets in any number of situations where some attribute of a company generates brand loyalty. For example, a customer shopping for salad dressing might select one from Newman's Own because they like the taste or because Newman's

[8] United States v. EI du Pont de Nemours & Co., 351 US 377, 395 (1956).

[9] *E.g.*, Bailey v. Allgas, Inc., 284 F.3d 1237, 1246 (11th Cir. 2002); American Key Corp. v. Cole Nat'l Corp., 762 F.2d 1569, 1579 (11th Cir. 1985)

[10] *See*, *e.g.*, Brown Shoe Co. v. U.S., 370 U.S. 294, 325 (1962).

[11] McWane, Inc., FTC No. 9351 (Feb. 6, 2014) http://www.ftc.gov/system/files/documents/cases/140206mcwaneopinion_0.pdf.

[12] *Id.* at 14-15. For clarity, it is important to note that customers can specify whether the parts to be used in the project are to be domestically produced or open to all bidders.

[13] Brief for Appellant at 32, McWane Inc. v. Federal Trade Commission, No. 14-11363 (11th Cir. filed Mar. 28, 2014).

Own donates 100 percent of after-tax profits to charity.[14] This attribute of charity permits Newman's Own to have some amount of price difference as compared to other salad dressings due to the fact that many consumers might choose to spend a little more knowing that their money is going to a good cause. However, it would seem unwise to classify products that give to charity as their own product market when they are otherwise indistinguishable from their competitors.

These attributes of a product can distort product market evidence. If something about the attribute causes the prices to rise, then those customers who are ambivalent or weakly loyal to the brand will defect. In the salad dressing example, if Newman's Own had to raise the price per bottle substantially higher than competing salad dressings then all customers but those intent on donating to charity would buy salad dressing from other brands. The extreme preference for Newman's Own and the price differential would give the appearance of a separate market for charitable salad dressing. However, this does not tell the whole story. Fiercely loyal Newman's Own customers would presumably still have a defection price point. Additionally, they may change their attitudes towards donating to charity through salad dressing purchases entirely. This example is not perfect because it would be hard to imagine a situation where Newman's Own would need to raise prices in such a manner. But the cost differences in producing some products in the United States often necessitate higher prices than their imported counterparts.

What occurs in this example is similar to an inverse "Cellophane Fallacy."[15] The Cellophane Fallacy states that undertaking a market definition analysis at monopolistic prices can lead one to define too broad a market and fail to identify market power when it is present. This happens because the product is priced so high that an additional small, but significant, price increase leads consumers to switch to imperfect substitutes. Consider, for example, customers who would replace overpriced cellophane with aluminum foil. In this example, an attribute that is valued by certain customers has created an increase in price such that only those who value it highly will continue to purchase. Examining a market by only looking at those extremely loyal customers can lead a market to be defined too narrowly and market power assumed when it is not present.

Returning to *McWane*, the market realities of the domestic iron pipe fittings market show why a narrow market definition is faulty. Most fittings used in the United States were manufactured domestically until just a few decades ago.[16] Importers began to successfully take business from U.S. manufacturers starting in the mid-1980s.[17] This process accelerated and in 2003 the U.S. International Trade Commission ("ITC") found that cheap imports were causing market disruption and material injury to the U.S. iron pipe fitting market.[18]

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[14] NEWMAN'S OWN, http://www.newmansown.com/charity/ (last visited Nov. 21, 2014).

[15] *See, e.g.*, George W. Stocking & Willard F. Mueller, *The Cellophane Case and the New Competition*, 45 AM. ECON. REV. 1 (1955).

[16] McWane, Inc., FTC No. 9351, 61 (May 9, 2013) (initial decision by administrative law judge) http://www.ftc.gov/sites/default/files/documents/cases/2013/05/130509mcwanechappelldecision.pdf.

[17] *Id.*

[18] *Id.* at 62.

Other manufacturers either cut domestic production or exited the market.[19] McWane became the last manufacturer standing with a full line of iron pipe fittings.[20] McWane closed one of its two iron pipe manufacturing plants and the last remaining plant was not running at full capacity.[21] In 2007, McWane booked $7 million in idle plant losses.[22] The differential caused by the higher costs of manufacturing iron pipe fittings domestically caused all customers to defect except for those that placed a high value on the attribute of American-made, and it is unclear whether even those costumers had immoveable hard preferences.

The fact that some of these American-made preferences were embodied in local laws does not necessarily convert this into a separate market. These laws are similar to a father that declares "absolutely no child of mine will ever buy a foreign car." Like the father, laws generally have numerous exceptions to account for special circumstances ("but Dad, there isn't an American car on the market that meets my needs"). Additionally, laws can be repealed just like the father's mind can be changed.

The FTC relies on a leading antitrust treatise to justify using this qualitative data alone to define the product market.[23] The treatise states that "[t]o the extent that regulation limits substitution, it may define the extent of the market."[24] However, this treatise also leaves open the possibility that it may not define a market. Under these circumstances, it seems like tried and true economic tests are still required to ensure that a domestically manufactured iron pipe fittings market exists.

The best evidence that the FTC relies on in setting a separate domestic market was a finding that McWane priced its domestic iron pipe fittings differently based on project specifications and not the cost of production.[25] The Commission came to this conclusion based on the price differential between McWane's domestic iron pipe fittings and its blended pipe fitting prices, which contain both domestic and imported iron pipe fittings.[26]

Unfortunately, there are other reasons why McWane might price its blended iron pipe fittings even substantially lower than its domestic iron pipe fittings. One likely reason is that McWane is trying to get rid of excess domestic iron pipe fitting inventory. Creating a blended price is a good way to do this because domestic iron pipe fittings can be sold at cost or at a loss without destroying their value. Another likely, and related, reason is to keep its domestic foundry running as efficiently as possible given the very low domestic demand. McWane may need to produce more tons than it could sell to domestic customers. In this case its only option is to run up domestic inventory and sell into open specifications because they can't run the foundry any less and still be efficient and keep their skilled people employed.

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[19] *Id.*

[20] *Id.*

[21] *Id.* at 12.

[22] *Id.* at 159.

[23] Brief for Appellee at 24-25, McWane Inc. v. Federal Trade Commission, No. 14-11363 (11th Cir. filed Mar. 28, 2014).

[24] IIB PHILLIP E. AREEDA, HERBERT HOVENKAMP, & JOHN SOLOW, ANTITRUST LAW ¶572b at 430 (3d ed. 2007).

[25] *Id.* at 15.

[26] *Id.*

These identification issues illustrate why the Commission's finding of a separate domestic iron pipe fitting market using qualitative evidence was woefully insufficient without being backed up by an accepted economic test. Such a test would confirm the FTC's theory and demonstrate that the qualitative evidence relied upon was not caused by external factors. There was very little reason not to conduct an economic test in *McWane* as there were a number of ways to get good data on the iron pipe fitting industry.

This over-reliance on qualitative evidence without an accepted economic test is not only a problem of law, but also a problem of policy. The FTC should always be an advocate for evidence-based antitrust analysis. Commissioner Wright explains evidence-based antitrust analysis as:

> harnessing the best available economic theory and evidence to improve decision-making about specific enforcement matters, policy decisions, resource allocation, agency design, and other critical decisions. The central idea is to wherever possible shift away from casual empiricism and intuitions as the basis for decision-making and instead commit seriously to the decision-theoretic framework applied to minimize the costs of erroneous enforcement and policy decisions and powered by the best available theory and evidence.[27]

Indeed, economists "have examined the effects of economists on competition authorities and conclude that the horizontal integration of economics into all levels of competition law decision-making increases the consistency and quality of analysis."[28]

The FTC's decision in *McWane* to use an intuitive market definition based on qualitative evidence without proving it through an economic test demonstrates Wright's point. The method the FTC used to prove a relevant market was easy to apply but with a significant potential for error. This method will be attractive for generalist judges to use in future antitrust cases even when, as here, there is data available to perform a more accurate economic based test.

## IV. CONCLUSION

Unfortunately, the results of following the FTC's method in *McWane* for defining a relevant market could be a significant step backwards in antitrust jurisprudence. There are a number of markets where external factors like American-made, charitable contributions of a manufacturing company, whether a company sources from Fair Trade certified suppliers, and even successful branding can create the appearance of a separate product market under the *McWane* precedent. Judges attempting to apply the *McWane* ruling in order to define a relevant product market might be tempted to define Starbucks coffee, Newman's Own salad dressing, and Coke as their own product markets due to strong consumer preference and possible price differences based on this preference.

It is far from unreasonable to require that qualitative evidence of a separate market be supported by an accepted economic test when the data required to perform such a test is readily available. This will lead to economic-evidence based antitrust analysis "best practices" that can be

[27] *Interview with Joshua D. Wright, Commissioner, Federal Trade Commission*, THE ANTITRUST SOURCE (August 2014), *available at* http://www.bingham.com/Publications/Files/2014/08/Interview-with-Joshua-D-Wright.

[28] Joshua D. Wright, *Abandoning Antitrust's Chicago Obsession: The Case for Evidence-Based Antitrust*, 78 ANTITRUST L.J. 1, 267 (2012).

applied by any judge. Such a requirement is consistent with sound antitrust law and will prevent over-enforcement and false positives in market definitions.